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JOHN F. DAVIS

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 650

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEAL FOR THE FIFTH CIRCUIT

PETITIONER'S BRIEF ON THE MERITS

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February 1966

OPINIONS BELOW

The Opinion under review is that of the Court of Appeals for the Fifth Circuit in United States of America vs. John Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, 346 F(2) 32(May 25, 1965), contained in the Transcript of Record (hereinafter designated "R"), at page 33. This decision was on an appeal from an Order of the District Court (R 25) affirming an Order of the Referee in Bankruptcy (R 19). There were no formal opinions by either the Referee or the District Judge.

JURISDICTION

The judgment before the Court for review was entered by the Court of Appeals for the Fifth Circuit on May 25, 1965. A Petition for Rehearing was filed on June 23, 1965, and an Order denying the Petition for Rehearing was entered on July 9, 1965. The Petition for Certiorari was filed with this Court on October 6, 1965. The jurisdiction of this Court rests on 27 U.S.C. § 1254, sub-section (1), and, also, Supreme Court Rule 19.1(b) which permits certiorari to courts of appeal where there is a conflict of opinion between the various circuit courts of appeal.

Jurisdiction of this Court is also based on 11 U.S.C., § 47(c); § 24(c) of the Bankruptcy Act, as Amended.

STATUTES INVOLVED

The Statutes and Regulations germane to consideration of this matter are listed below, and their full text is set out in Appendix A.

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A. The Acts of Congress Relating to Bankruptcy:

11 U.S.C. § 75(a) (Sec. 47a-Bankruptcy Act) Trustees; duties. 1

11 U.S.C. § 104 (Sec. 64 Bankruptcy Act) Debts which have priority 2

11 U.S.C. § 778 (Sec. 378 Bankruptcy Act) Procedure upon order directing that bankruptcy be proceeded with 5

B. The Internal Revenue Code of 1954:

26 U.S.C. § 3504, Acts to be performed by agents. 6

26 U.S.C. § 4231(6), Cabarets. 7

26 U.S.C. § 6011(a), General requirement of return, statement, or list. 7

26 U.S.C. § 6012(b)(3), Receiver, trustee, and assignees for corporations. 8

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QUESTIONS PRESENTED

1. WHETHER THE RULE THAT CLAIMS IN LIQUIDATING BANKRUPTCY DO NOT DRAW INTEREST IS ALTERED BECAUSE THE CLAIM WAS FOR TAXES INCURRED BY A DEBTOR IN POSSESSION IN A BANKRUPTCY ACT CHAPTER XI DEBTOR RELIEF PROCEEDING THAT PRECEDED THE ADJUDICATION AND LIQUIDATION.

2. WHETHER A TRUSTEE IN BANKRUPTCY IS LIABLE FOR PENALTIES FOR FAILURE TO FILE TAX RETURNS FOR CABARET EXCISE TAX, FUTA, FICA AND WITHHOLDING TAXES WHEN THE TAXES WERE THE LIABILITIES OF A PREDECESSOR DEBTOR IN POSSESSION DOING BUSINESS UNDER A CHAPTER XI PROCEEDING OF THE BANKRUPTCY ACT.

STATEMENT OF THE CASE

On August 6, 1958, Beachcomber Motel, Inc. filed a voluntary Petition for Arrangement with its unsecured creditors, under Chapter XI of the Bankruptcy Act, 11 U.S.C., § 722, Bankruptcy Act § 322 (R. 1). On September 17, 1958, the corporation, having failed to present a Plan acceptable to its creditors, was adjudicated a bankrupt- (R 37). Between the filing date and the date of adjudication, September 17, 1958, Beachcomber Motel, Inc. had operated its motel business as a Debtor in Possession under authority of the Bankruptcy Court.

The United States filed a claim for taxes in the subsequent liquidating bankruptcy proceedings (R 9). The claim included pre-petition taxes that had accrued prior to August 6, 1958, the date of the filing of the Chapter XI petition and, also, a claim for taxes described as "administrative expense taxes." The "administrative expense taxes," were for taxes incurred by the Debtor in Possession between the date of the filing of the Petition for Arrangement and that of the entry of the order of adjudication, on September 17, 1958. Petitioner Trustee does not deny his obligation to pay the pre-petition taxes as a priority claim under Section 64(a)(4) of the Bankruptcy Act, nor his obligation to pay that portion of the "administrative expense taxes" representing the principal portion of the tax obligations incurred by the Debtor in Possession, as a cost of administration, under Section 64(a)(1), of the Act.

The Trustee objected to the portion of the claim of the Government which requested payment, from the bankrupt estate, as part of the Government's administrative claim under Section 64(a)(1) of the Act, post-adjudication interest and penalties on the "administrative expense taxes" incurred by the Debtor in Possession (R 10, 11). The Debtor in Possession incurred administrative tax liability to the United States of $519.89 for withholding and Federal Insurance Compensation Act (FICA) taxes; $644.00 for cabaret or excise taxes; and $362.29 for Federal Unemployment Tax (FUTA) taxes. The Government claimed, as part of its administrative claim under Section 64(a)(1), these amounts, and assessed interest, and accrued interest on each of these taxes. The FICA taxes and interest were assessed on February 2, 1962; the excise taxes and interest were assessed on April 14, 1959, and

the FUTA taxes were assessed on April 14, 1959. Accrued interest was claimed from date of assessment to date of filing of the claim, which was April 11, 1963, and, also, the claim requested liability for interest on the entire principal amount from April 11, 1963, to date of payment.

The claim also requested assessed penalties for alleged failure of the trustee in bankruptcy to file tax returns for the Debtor in Possession in the three areas of tax liability.

The Referee in Bankruptcy sustained the objection and denied the Government's demand for interest to date of payment, accrued interest and penalties, and allowed as an administrative expense the principal balance of the three taxes and the assessed interest thereon (R 12, 13).

The Government filed a petition for review to the United States District Court from the order of disallowance of the penalties and accrued interest (R 14, 15).

The District Court affirmed the Order of the Referee (R 16).

On appeal by the United States, the Court of Appeals for the Fifth Circuit reversed and allowed the penalties, accrued interest, and interest to date of payment, and penalties for failure to file returns, all as costs of administration, in the liquidating bankruptcy (R 21).

ARGUMENT

POINT I

CONGRESS HAS PROVIDED AN ORDERLY, EQUITABLE DISTRIBUTION OF BANKRUPT ESTATES BY ESTABLISHMENT OF SPECIFIC PRIORITIES, AND A DEPARTURE FROM THE PRECISE PLAN SHOULD BE AVOIDED.

The plan established by Congress in the Bankruptcy Act for an orderly distribution of assets from liquidating bankruptcies has been strictly observed and deviations therefrom have not been judicially favored. The Government's claim in the estate of Beachcomber Motel, Inc. is accorded a specific priority under § 64(a)(1) of the Bankruptcy Act as a cost of administration. The effect of the instant decision of the Fifth Circuit is to grant to the Government a position superior to that specifically provided in the Bankruptcy Act. The decision creates a super-priority requiring either premature payment of the Government's claim, or the exaction of a unique and unprecedented accumulation of interest until the date of payment of claim, completely alien to the Government's clearly established position on the well defined ladder of priorities.

The Court of Appeals for the Eight Circuit, in **United States v. Kalishman,** (CA 8 1965) 346 F(2)514, decided June 4, 1965, considered the same problem and reached an opposite conclusion. The Eighth Circuit rejected the Government's contention that interest on unpaid withholding taxes should be a continuing obligation of a trust-

ee in liquidating bankruptcy merely because the taxes were incurred by a debtor in possession in a debtor relief proceeding under Chapter XI of the Bankruptcy Act.

All costs of administration incurred during the operation of a debtor in possession are on a parity. The claim of the sovereign has no priority over other costs of administration and distribution to the Government must be in accordance with the statutory plan provided by Congress. This rule is well recognized in situations where straight bankruptcy liquidation follows a Chapter XI arrangement proceedings, as in the instant matter. See **State of Missouri v. Earhart** (CCA 8, 1940) 111F(2) 922.

The purpose of bankruptcy proceedings is to collect the assets of the debtor and equitably distribute them to the creditors, in accordance with the priorities prescribed in the Bankruptcy Act. **Guarantee Title & T. Co. v. Title Guaranty & S. Co.**, 224 U.S. 152, 56 L. Ed. 706, 32 S. Ct. 457, held that § 3466 of the Revised Statutes, now 26 U.S. Code, § 960, the insolvency statute, would not prevail over the specific provisions of the Bankruptcy Act. In the **Guarantee Title** case, this Court held that wage claims allowed a second priority under Section 64 of the Bankruptcy Act prevailed over taxes, accorded a fourth priority.

In **Davis v. Pringle**, 268 U. S. 315, 45 S. Ct. 549, 69 L.Ed. 974, another attempt by the Government to invoke the provisions of § 3466 of the Revised Statutes was rejected by this Court. The reasoning of **Davis v. Pringle** is still applicable, although the statute has been amended to effectuate the Government's contentions in that case.

In **Matter of Connecticut Motor Lines**, 336 F(2) 96 (CCA 3, 1964), the Third Circuit thoroughly considered the meaning and intent of the priority section of the Bankruptcy Act, § 64(a), and the status of claims for withholding and FICA taxes arising from wages due prior to the bankruptcy, but paid during the bankruptcy. The Court followed the applicable legislative intent to uphold the provisions of the Bankruptcy Act and strictly applied the priorities provided.

Necessary to the orderly administration of the Bankruptcy Act is observance of the axiom that even revenue producing statutes must necessarily be interpreted in contemplation of the Bankruptcy Act and bankruptcy statutes must prevail.

United States v. Speers, 86 S. Ct. 411 (1965) _____ U.S._____ is the most recent illustration of this Court's application of this rule in its consideration of the relation of § 70 of the Act, 11 U.S.C., § 110, and 26 U.S.C. § 6323 of the Internal Revenue Code. The Court held that there was no conflict in the two statutes but the congressional intent in the Bankruptcy Act is accredited its full and complete meaning without reservations, notwithstanding an enactment by the Internal Revenue Code on the same subject matter.

If the intent of Congress, as expressed in its establishment of priorities in Section 64 of the Bankruptcy Act, is to be followed, then distributions must be made in express compliance with those priorities, unless there is a clear expression of legislative intent to the contrary. General tax revenue statutes have not been recognized as furnishing a basis for altering the Bankruptcy Act's

prescribed outline of distribution. The allowance of post-adjudication interest on a tax claim would constitute such an alteration and should not be permitted.

This Court recognized the inter-relations of the revenue statutes and the Bankruptcy Act in **City of New York v. Saper**, 336 U.S. 328, 69 S. Ct. 554, 93 L. Ed. 710 (1949), The Court succinctly stated its position with the observation:

> "We do not believe the Revenue Act of 1924 and similar enactments were intended to amend the comprehensive scheme of the Bankruptcy Act."

The **Saper** case involved taxes due prior to commencement of a bankruptcy proceeding, unlike the taxes under consideration here.

This is not a distinguishing feature. The controlling similarity of this proceeding with that in the **Saper** case is that in both situations the Court deals with liquidating bankruptcies under Chapters I through VII of the Act and the rationale of **Saper** is as much applicable here as it was in the proceedings then before the court. Adaptation of the rule of the **Saper** case by the various courts of appeal is found in **Adams v. O'Malley** (CA 8, 1950) 182 F(2) 925; **United States v. Bradley** (CA 5 1963) 321 F(2) 224, and **In Re Connecticut Motor Lines**, supra;

Frequently, operations by a debtor in possession are unsuccessful, and it cannot be determined until final meeting whether there will be enough on hand to pay costs of administration claims in full. If the strict priorities prescribed by the Bankruptcy Act are not followed and

their prescriptions can be abrogated by awards of continuing interest, as the ruling of the Fifth Circuit has allowed, the Trustee, with an estate insufficient to satisfy all priority obligations, and attempting to allocate funds to pay the claims and cost of administration expenses, is inevitably faced with a dilemma. If the Trustee is required to pay one or more of the costs of administration claims in full, and then it turns out that there are insufficient funds to pay all of such parity claims, some of such creditors have been treated unfairly, and the Trustee will be liable on his bond. The situation in **United States v. State of New York**, 315 U.S. 510, 62 S. Ct. 712 (1942) was an example of an estate with insufficient assets to pay all of the § 64(a)(1) priority claims.

To delay payment and incur interest as required by the ruling of the Fifth Circuit, may result in a diminution of the dividend payable on claims of equal dignity and certainly penalizes claims of inferior dignity. The principle of forcing premature payment of **certain** taxes under penalty of incurring an obligation to pay post-adjudication interest is not only completely alien to ordinary bankruptcy procedures and their statutory bases, but is inequitable to creditors and, Petitioners contends, is without legal foundation or precedent. The arguments which support the requirement that interest be paid on taxes to force timely payment is absent in these circumstances. Admittedly, the imposition of interest is a logical requirement to motivate the taxpayer to pay taxes. The need for such motivation is not applicable to a liquidating bankruptcy procedure under Chapters I through VII of the Act.

POINT II

ALLOWANCE OF POST BANKRUPTCY INTEREST ON TAX CLAIMS IS INEQUITABLE TO OTHER CREDITORS AND ADMINISTRATIVELY BURDENSOME.

City of New York v. Saper, supra, establishes the rule from which Petitioner contends the Fifth Circuit has departed: Post-petition interest is not allowable on claims, whether for taxes, or otherwise. The Saper decision dealt with interest on taxes that accrued prior to the bankruptcy proceeding, as contrasted with interest on taxes accruing prior to adjudication as in the instant facts. The controlling similarity of this proceeding with that in the Saper case is that in both situations the Court deals with the award of interest accruing during a liquidating bankruptcy. The rationale of the Saper case is equally applicable here. The rationale of the Saper case is that it is inequitable to allow interest to the Government on funds while those funds are in the hands of a trustee in bankruptcy. The Court pointed out that to allow such interest would grant the Government preferred treatment over other claimants of equal priority and there was nothing in the law which justified the conclusion that Congress intended to give the Government such preferred treatment. Saper recognizes the principle that liquidation of estates in bankruptcy requires that continuing obligations must cease at some point and the amounts of claims be determined for the fixing of priorities and for distribution. Sound administration and calculation of dividents is otherwise impossible. 3 Collier on Bankruptcy, 14th Ed. § 63.16(2). Saper was followed by United States v. Edens, 342 U.S. 912, 96 L. Ed 682, 72 S. Ct. 357, and

United States v. General Engineering & Manufacturing Co., 342 U.S. 912, 96 L. Ed. 682, 72 S. Ct. 358. **United States v. Edens**, supra, is a decision affirming a Fourth Circuit decision reported at 189 F(2) 876, in which the Court of Appeals recognized the inequity of allowing interest on tax claims and applied this rule to reorganization proceedings, as well as to straight bankruptcy proceedings. The Court stated that no single class of creditors should be able to benefit at the expense of another class of creditors, particularly when any delay in payment of claims was caused by application of an Act of Congress and not by the dilatory activities of the taxpayer. This opinion rebuffs the Government's instant contention that its claim should be paid prior to general distribution and that interest should be approved as a penalty for that nonpayment. If the Government prevails in its position, it is not the Trustee who is penalized for non-payment, but it is the other creditors, who have no control as to the date of payment of taxes. The inequitable and impractical effect of requiring interest on certain claims in bankruptcy proceedings, whether in reorganization poceedings or straight bankruptcy, is well accepted and has received consistent recognition in all of the Federal decisions since the **Saper** case. The Fourth Circuit, in **United States v. Harrington**, 269 F(2) 719, recognized the rule against post-petition interest on tax claims in order to prevent inequities, and the penalizing of other creditors because of that interest payment. Recently, the reasoning of this Court in the **Saper** case was reasserted in **Smith v. Robinson** (CA 4, 1965), 343 F(2) 793, in which post-petition interest on claims in a Chapter X proceeding was denied.

In **Vanston Bondholders Protect. Com. v. Green**, 329

U.S. 156, 91 L. Ed. 162, 67 S. Ct. 237, certain bondholders were denied interest, notwithstanding their contractual obligation, because of the inequitable result of denying such interest payments to other creditors with claims of equal dignity. The logic of the **Saper** case, supra, is plain and persuasive. In **State of New York v. Feinberg**, (CCA 2), 204 F(3) 502, the Court of Appeals considered a Chapter X proceeding in which the State objected to a plan of reorganization providing for issuance of bonds to pay the State's claim for taxes when such bonds carried interest at a rate lower than that provided by New York law. The rationale of the opinion, denying the State's claim, was that the state is not entitled to post-petition interest on its claim in any event and, therefore, could not be heard to complain as to the rate of interest set by a Plan.

The rationale of **Saper, Vanston Bondholders**, and the other authorities supporting the refusal of post-adjudication interest on claims in bankruptcy, coupled with the recognition of the administrative burden of calculating such interest, persuaded the Referee and the District Judge to deny post-adjudication interest in the matter at hand. These considerations were recognized by the Court of Appeals for the Eighth Circuit in the **Kalishman** case, supra, which is in direct conflict with the decision on review here.

The only distinguishing feature the Fifth Circuit finds in the facts at hand from those in the **Saper** case, supra, is that in the facts at hand, the liquidating bankruptcy administration superseded Chapter XI arrangement proceedings.

The effect of the rule imposed by the Fifth Circuit in this Opinion, in conflict with the **Kalishman** decision, is that the Trustee in liquidating bankruptcy must pay, prematurely, and out of turn, claims for taxes which are even inferior in dignity to the expenses of the bankruptcy administration itself, as provided in § 64(a)(1) of the Act. The alternative, is to incur a continuing obligation of interest to be paid out of the estate to the prejudice of other creditors, some of whom are on equal priority status as the claim of the Government.

The Government's claim in the instant matter, as an "expense of administration" was accorded Class 1 priority under § 64 of the Bankruptcy Act. It is limited only by the fact that it is an expense of a superseded debtor relief proceeding. That fact, by the express language of § 64, subordinates this claim to the expenses of the administration necessary for the liquidation of the bankrupt estate

The taxes under consideration here, Withholding, FICA, FUTA and cabaret excise, became returnable at a time after the termination of the Chapter XI Debtor in Possession administration and during the period of administration of the liquidating trustee in bankruptcy.

If interest is permitted on the taxes from the date they are returnable, notwithstanding the fact that it is a date within the administration of a liquidating bankruptcy, the trustee is then faced with a dilemma. Payment of taxes prematurely by the Trustee may be at the peril of reducing his estate and not having sufficient assets to pay administration expenses superior to the tax claim.

Saper, Kalishman and other authorities disallowing interest, recognize that the persuasive reasons for interest accruing on unpaid principal of taxes is absent in a liquidating bankruptcy proceeding. If the entity incurring liability continues to exist and operate, imposition of interest is a logical requirement to persuade such continuing entity to pay its taxes. By way of example, the liability surviving bankruptcy for non-dischargeable taxes, the liability of a continuing trustee in bankruptcy receivership proceedings are reasonable subjects for interest imposition. The distinguishing features between the allowance of post-petition interest on entities other than a liquidating bankruptcy trustee was recognized by this court in **Bruning v. United States,** 376 U.S. 358, 11 L. Ed. (2) 772, 84 S. Ct. 906. There, the court allowed post-petition **interest** on a continuing obligation of a debtor inasmuch as taxes are non-dischargeable in bankruptcy. The court specifically acknowledged the logic and persuasiveness of the **Saper** ruling in the liquidating trustee situation. **Boetler v. Ingels,** 308 U.S. 57, 84 L. Ed. 78, 60 S. Ct. 29, is another instance where penalties were allowed on taxes but such allowance was against an operating trustee. The operating trustee failed to obtain a license to continue his business and the penalties were upheld during the continuing administration. Not considered, however, was the imposition of the penalties on a later liquidating bankruptcy proceeding. The Fifth Circuit opinion in this case (R 33) cited **Boetler v. Ingels,** supra, as authority for the imposition of interest and penalties on the liquidating trustee in this particular case. The opinion, however, does not recognize the distinguishing nature of the liquidating bankruptcy procedure as opposed to the continuing entity of a Chapter XI debtor in possession or a trustee or receiver. This distinction was

specificall yrecognized by this Court in **Bruning v. United States**, supra.

The motivation to pay taxes created by the imposition of interest on the principal amount is absent in its application to trustees in liquidating bankruptcy estates. The straight bankruptcy trustee has a specific duty under the law to gather the assets and allot to the government its proper statutory priority. All of these activities are under the supervision of the court, to which the government has access to compel the trustee to more expeditious activity if there is a delay unwarranted by the circumstances.

The distinguishing nature of the liquidating straight bankruptcy in contrast to the continuing trustee operating a business or other continuing entity raises another problem not acknowledged by the Fifth Circuit in the opinion entered in this cause.

The trustee in bankruptcy is required under the duties contained in the Act to collect the assets of the debtor and then make equitable distribution in pro rata shares recognizing the scale of priorities set out in the Act.

To properly carry out this responsibility, it follows that liability on the various claims must at some point cease and allocation of shares take place.

This principle is fundamental in liquidating bankruptcies and there is no reason that it should not be applicable to a liquidating bankruptcy that succeed an unsuccessful debtor relief proceedings. The rule estab-

lished by the Fifth Circuit in this instance singles out this one exception and ignores the compelling practical problems inherent in the ruling which will necessarily complicate conclusion of such superseded bankruptcy proceedings. See 3 Collier on Bankruptcy, page 1855.

POINT III

THE BANKRUPTCY ACT, § 378(2) IS NOT AN EXPANSION OF THE LIABILITIES AND DUTIES OF A TRUSTEE IN LIQUIDATING BANKRUPTCY BUT MERELY A DEFINITION OF THE TIME FROM WHICH THE TRUSTEE'S RIGHTS ACCRUE.

The original petition of the Debtor, Beachcomber Motel, Inc. was under Chapter XI of the Bankruptcy Act, so when straight bankruptcy was ordered Section 378, sub-section (2) was activated rather than sub-section (1). The pertinent portion of sub-section 2 reads as follows:

> "(2) in the case of a petition filed under section 722 of this title, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed;"

The Court of Appeals for the Fifth Circuit in these proceedings, and the Court of Appeals for the Eight Circuit both considered the application of § 378(2) with

respect to the charge by the Government that the trustee in liquidating bankruptcy is responsible for interest on tax liabilities of his predecessor debtor in possession. The Fifth Circuit has interpreted § 378 as imposing an expansion of the duties of a trustee in liquidating bankruptcy.

The effect of the holding of the Fifth Circuit in this proceeding is that a debtor in possession and its successor trustee in liquidating bankruptcy is one administration and liabilities and obligations of the debtor in possession conducting a business become the liabilities and obligations of the liquidating trustee. The decision of the Fifth Circuit ignores the existing legislation in the direction of Section 64(a)(1) of the Bankruptcy Act that the expenses of administration of a liquidating bankruptcy are to be paid in full prior to the payment of the obligations of a debtor relief proceeding. Thus, the straight bankruptcy trustee, succeeding to any Chapter XI proceeding, cannot evaluate his liabilities and duties by the traditional obligations of a trustee under Chapters I through VII of the Act but he must inquire into and shoulder the responsibilities of his predecessor notwithstanding the different nature of the two proceedings.

An examination of § 378 in the context of the entire Chapter XI of the Act demonstrates that it is designed to implement the transition from an active debtor relief proceeding into a straight bankruptcy under Chapters I through VII of the Act.

This section defines the time when the rights of the trustee in bankruptcy accrue and relates them back to the time of the original petition under Chapter XI.

H.R. Report No. 17-245, 55th Congress, 2nd Session, 1897-1898; H.R. Report 1042, 75th Congress, 1st Session, 1938.

The function performed by § 378 of the Bankruptcy Act is the solution of the problem of whether the trustee in bankruptcy succeeds to propery rights as of the date of adjudication, or as of the date of the filing of the original petition under the debtor relief proceeding. In **Miller v. Wooley** (CA 9, 1944) 141 F(2) 837, and **Wood v. Scott** (CA 6, 1950) 180 F(2) 252, the effect of §378 is described as a retroactive adjudication in bankruptcy following the interpretation that § 378 is nothing more than a relation of the time when the rights of the trustee accrue.

Such a determination is necessary since in numerous places in the Bankruptcy Act, the rights of the trustee are defined with respect to designated periods of time in relation to the date of the Petition.

The pinpointing of a fixed time with respect to determination of priorities is necessary as determined in Section 64 where priorities are allowed wage claimants for a period of three months and rent for a three month period and Section 60 (11 U.S.C. §96), as to preferences and Section 67 (11 U.S.C. §107) as to fraudulent conveyances, all relate to a set period of time in reference to the filing of the Petition. Again, in §70 (11 U.S.C. § 110), the filing of the Petition is important for determining the rights and title of the Trustee in property of the bankrupt.

Two significant propositions should be considered in the application of §378. The first, is that §378 by its

own terms is not mandatory, but requires that the proceedings after adjudication should be conducted, "so far as possible" as if the original petition for adjudication had been filed at the time that the debtor relief petition was filed. Secondly, it is certainly a revolutionary expansion of the duties of the trustee required by §47 of the Act (App. 1) to impose on the liquidating trustee, the responsibility for the conduct of the operating debtor in possession, including liabilities for continuing interest that would have been the obligation of the debtor in possession had it continued to operate the business.

Additionally, it is unnatural to identify the trustee with the debtor in possession. Identity of the two entities should not be attributed because of a similarity of powers. It is an unfair imposition of responsibility on the creditors' representative whose very election is often the result of heated antagonism with the debtor in possession and the result of disenchantment by the creditors with the debtor's conduct.

In this instance, the interpretation of §378 by the Fifth Circuit disrupts the entire scheme of priorities elaborately developed in §64 of the Act. The analysis supporting the rule denying post-petition interest established in **City of New York v. Saper**, supra, and other authorities that followed **Saper**, is abandoned by the novel view accepted by the Fifth Circuit in this proceeding.

The expansion of the scope of §378 of the Bankruptcy Act beyond the mere fixing of the date from which the trustee's rights accrue in his administration of a liquidating bankruptcy, is unwarranted by the language of that

Section and inconsistent with the reasonable and orderly administration of the Act.

POINT IV.

THERE IS NO DUTY IMPOSED BY THE INTERNAL REVENUE STATUTES ON LIQUIDATING TRUSTEES IN BANKRUPTCY TO FILE WITHHOLDING-FICA, FUTA AND CABARET TAX RETURNS ON BEHALF OF A PREDECESSOR DEBTOR IN POSSESSION.

The tax return requirement contained in the opinion of the Fifth Circuit, to which this Petition for Certiorari is directed, imposes on a trustee in bankruptcy a duty to file on behalf of a predecessor debtor in possession, tax returns for the debtor in possession for withholding taxes, excise taxes, FUTA and FICA taxes.

There is no duty imposed on a trustee in bankruptcy, by the revenue statutes which require the filing of these tax returns, for an entity and operation other than his own.

The portion of the Internal Revenue Code requiring the filing of returns for cabaret taxes is contained in 26 U.S.C.A., §4231, sub-section 6 (App.).

Returns for Withholding taxes, FICA and FUTA taxes are required in 26 U.S.C.A., §6011 (App. 7)

Congress does not impose the responsibility of filing the returns for these taxes on any person other than the person receiving the income or collecting the revenue.

In the facts before the Fifth Circuit concerning the Beachcomber Motel, Inc., the person receiving the income of collecting the revenue, of course, was the debtor in possession under the Chapter XI proceeding. If the debtor in possession administration had continued to the date when the returns were due, it would have been its officers' duty to file the returns and pay the tax as it would have been an entity with a continuing responsibility under the rule of **Boetler v. Ingels**, supra.

Likewise, if the Trustee had conducted the business and incurred tax liability for the various taxes involved here, it would have been his responsibility to file returns by the direct requirement of 28 U.S.C., §960 (App.).

The latter Section limited its application to trustees "conducting a business". There is, of course, no showing that the Trustee in Bankruptcy conducted a business in the process of liquidating the estate of Beachcomber Motel, Inc.

In fact, the arrangement failed and an adjudication was entered and the Debtor in Possession was dispossessed and the motel operation closed.

The intent and meaning of 28 U.S.C., §960, has been thoroughly considered by the Ninth Circuit in **California Board of Equalization v. Goggin**, 191 F(2)726 (CA 9, 1951), 27 A.L.R (2nd) 1211, (cert. den.) 342 U.S. 909, 72 S. Ct. 302, 96 L. Ed. 680, and, also, **California Board of Equalization v. Goggin**, 245 F(2) 44 (CA 9, 1957) (cert. den. 353 U.S. 961 77 S. Ct. 863 1 L. Ed. 2910). In the 1951 case, the trustee in bankruptcy succeeded a Chapter XI proceeding and made sales as trustee. Thereafter, a liquidation order was entered by the court and a sale was concluded

pursuant to it. Sales taxes were paid on the Chapter XI sales and, also, on subsequent sales made as trustee, but not on the final liquidation sale as ordered by the court. The liquidation sale was considered to have been an act not in the conduct of a business and, therefore, the trustee was not liable for taxes under the requirement of 28 U.S.C., §960.

The 1957 opinion again considered 28 U.S.C. §960 with almost identical circumstances and the court again drew the exact distinction between sales "in the conduct of any business", and the sales in the liquidation of the bankrupt estate pursuant to court order.

Petitioner contends that the same distinction recognized by the Ninth Circuit applies to the liquidating bankruptcy in this proceeding. The trustee in straight bankruptcy, liquidating a business that never operated under his control, is not bound by the provisions of 28 U.S.C., §960.

An example of the direct congressional enactment imposing on a trustee the obligation to file returns for a predecessor is contained in 28 U.S.C. §6012 (App. 8). This Section, of course, applies only to income taxes. No comparable provision has been found in the internal revenue statutes as to Withholding, FICA, FUTA or the cabaret taxes under consideration in this proceeding.

It then follows that the penalties claimed by the government for failure to file tax returns should not have been upheld by the Fifth Circuit as there is no statutory authority requiring the filing of those returns by the liquidating trustee in bankruptcy and they are certainly not listed as one of the duties under §47 (11 U.S.C. §) of the Act. (App. 1)

CONCLUSION

Petitioner, JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, submits that the Court should adhere to the rule of City of New York v. Saper and deny interest on claims in liquidating bankruptcy.

The equitable and practical basis for denial of interest in liquidating bankruptcy is present whether the claim arose prior to the original Petition or during the administration of a debtor in possession under a debtor relief proceeding.

Further, the requirement by the holding of the Fifth Circuit in this proceeding that a trustee in bankruptcy is responsible to file tax returns for Withholding-FICA, FUTA and Excise tax for revenue collected by a Chapter XI debtor in possession is not required by existing legislation and should be excused.

The judgment of the Fifth Circuit should be reversed and the Order of the District Court should be affirmed.

Respectfully submitted,

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By: _____
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CERTIFICATE OF SERVICE

I, JOHN H. GUNN, Attorney for JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankruptcy, Petitioner, and a member of the Bar of the Supreme Court of the United States, hereby certify that on the_____day of February, 1966, I served copies of the foregoing PETITIONER'S BRIEF ON THE MERITS by mail, by depositing the same in a United States mail box, with first class postage prepaid, addressed to counsel of record at their post office addresses, as follows:

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APPENDIX

The Statutes and Regulations necessary for consideration of the issues involved.

11 U.S.C. §75(a) (Sec. 47a Bankruptcy Act) Trustees; duties.

> (a) Trustees shall (1) collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estates as expeditiously as is compatible with the best interests of the parties in interest; (2) deposit all money received by them in designated depositories initially in demand deposits; and subsequently, if authorized by the court, in interest-bearing savings deposits, time certificates of deposit, or time deposits-open account; (3) account for and pay over to the estates under their control all interest received by them upon funds belonging to such estates; (4) disburse money only by check or draft on such depositories; (5) keep records and accounts showing all amounts and items of property received and from what sources, all amounts expended and for what purposes and all items of property disposed of; (6) set apart the bankrupts' exemptions allowed by law, if claimed, and report the liens and estimated value thereof to the courts as soon as practicable after their appointment; (7) examine the bankrupts (a) at the first meetings of creditors or at other meetings specially fixed for that purpose, unless they shall already have been fully examined by the referees, receivers, or creditors, and (b) upon the hearing of objections, if any, to their

discharges, unless otherwise ordered by the court; (8) examine all proofs of claim and object to the allowance of such claims as may be improper; (9) oppose at the expense of estates the discharges of bankrupts when they deem it advisable to do so; (10) furnish such information concerning the estates of which they are trustees and their administration as may be requested by parties in interest; (11) pay dividends within ten days after they are declared by the referee; (12) report to the courts in writing the condition of the estates, the amounts of money on hand, and such other details as may be required by the courts, within the first month after their appointment and every two months thereafter, unless otherwise ordered by the courts; (13) make final reports and file final accounts with the courts fifteen days before the days fixed for the final meetings of the creditors; and (14) lay before the final meetings of the creditors detailed statements of the administration of the estates.

11 U.S.C. §104 (Sec. 64 Bankruptcy Act) Debts which have priority.

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estates subsequent to filing the petition; the fees for the referees' salary and expense

fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under Chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred

in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and

owing by the bankrupt to the United States or any State or any subdivision thereof; **Provided,** That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: **And provided further,** That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: **Provided,** however, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

11 U.S.C. §778 (Sec. 378 Bankruptcy Act). Procedure upon order directing that bankruptcy be proceeded with.

Upon the entry of an order directing that bankruptcy be proceeded with—

(1) in the case of a petition filed under section 721 of this title, the bankruptcy proceeding shall be deemed reinstated and thereafter shall be conducted, so far as possible, as if such petition under this chapter had not been filed; and (2) in the case of a petition filed under section 722 of this title, the proceeding shall be con-

ducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 72 of this title.

Internal Revenue Code of 1954:

26 U.S.C. Sec. 3504. Acts to be performed by agents. (As amended by Sec. 71, Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606)

In case a fiduciary, agent, or other person has the control, receipt, custody, or disposal of, or pays the wages of an employee or group of employees, employed by one or more employers, the Secretary or his delegate, under regulations prescribed by him, is authorized to designate such fiduciary, agent, or other person to perform such acts as are required of employers under this title and as the Secretary or his delegate may specify. Except as may be otherwise prescribed by the Secretary or his delegate, all provisions of law (including penalties) applicable in respect of a nemployer shall be applicable to a fiduciary, agent, or other person so designated but, except as so provided, the employer for

whom such fiduciary, agent, or other person acts shall remain subject to the provisions of law (including penalties) applicable in respect of employers.

26 U.S.C. Sec. 4231. (6)—Cabarets.

A tax equivalent to 20 percent of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. The tax imposed under this paragraph shall be returned and paid by the person receiving such payments. No tax shall be applicable under paragraph (1) or (2) on account of an amount paid with respect to which tax is imposed under this paragraph.

26 U.S.C. Sec. 6011. (a)—General requirement of return, statement, or list.

(a) General rule—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

26 U.S.C. Sec. 6012 (b)(3)—Receivers, trustees and assignees for corporations.

In a case where a receiver, trustee in bankruptcy, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver, trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

26 U.S.C. Sec. 6601(a). Interest on underpayment, nonpayment, or extensions of time for payment, of tax.

(a) General Rule. If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

26 U.S.C. Sec. 6651. Failure to file tax return.

(a) Addition to the tax. In case of failure to file any return or required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or a sub-

chapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

28 U.S.C. Sec. 960. Tax liability.

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Treasury Regulations on Employment Tax (1954 Code):

§31.6071(a)—1 Time for filing returns and other documents. (a) Federal Insurance Contributions Act and income tax withheld from wages. (1) Quarterly or Annual returns. Each return required to be made under §31.6011 (a)—1, in respect of the taxes imposed by the Federal Insurance Contributions Act, or required to be

made under §31.6011 (a)—4, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. However, any such return may be filed on or before the tenth day of the second calendar month following such period if such return is accompanied by depositary receipts, Form 450, showing timely deposits in full payment of such taxes due for such period. For the purpose of the preceding sentence, a deposit which is not required to be made within such return period may be made on or before the last day of the first calendar month following the close of such period, and the timeliness of the deposit for any month will be determined by the earliest date stamped on the validated Form 450 by an authorized commercial bank or by a Federal Reserve bank.